Financial Markets

Irving Trust

Irving Trust Company
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Economic Research & Planning Division

Friday
(Noon)

July 31, 1981

Financial markets this week were poised on the threshold of a realignment of rate levels. The week saw the rate on Federal funds (belatedly) move down out of the 19%-20% range and solidly into the 17%-18% area. Yet many market participants--having been deceived again and again in weeks past--were understandably reluctant to believe that at last the funds rate would begin to reflect the Fed's reduced pressure on bank reserves positions. Nevertheless, by the end of the week, one could detect a spreading conviction that the peak in the funds rate was behind us.

Despite that improvement, however, the long-term bond market lost ground over the week, reflecting the near absence of retail buying interest, as well as the palpable threat to government securities dealers represented by next week's Treasury refunding, in which $4.25 billion 3 1/4-year notes will be offered on Tuesday, $2.25 billion 9 3/4-year notes on Wednesday, and $2.0 billion 29 3/4-year bonds on Thursday. The $8.5 billion total was on the high side of market expectations, as was the Treasury's $33 billion estimate of its fourth quarter financing needs, so the Wednesday afternoon announcement was destined to be a disappointment. Immediately afterwards, the Treasury's long bond dropped about a point in price.

Against that background, the refunding should perform better than expected, since the market already appears to have discounted every conceivable disappointment. The high yields expected in the auctions should prove very attractive to investors, and if so, then the market's tone should improve. A continued 17%-18% funds rate should offer further support.

The pattern of recent Federal Reserve open market operations--i.e., 4-day RPs on Thursday in the last four statement weeks--suggests strongly that the System is anxious to damp upward pressure on the funds rate before the weekend, and thus to minimize problems in achieving the desired average level of discount window borrowing during the week. That suggests that pressure on bank reserves positions may well be in process of being reduced still further, with a lower funds rate the likely implication. Nevertheless, we expect that additional rate declines will be only gradual.

Warning: Today the air traffic controllers announced their intention to strike starting Monday, August 3. Should a strike actually take place, Federal Reserve float will increase, injecting reserves into the banking system. That will necessitate substantial reserves draining operations by the Fed. The operations will be technical and should not be interpreted as a firming of the Fed's policy stance.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

	7/31/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.50	20.50%	11.00%
Effective since	7/8/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	10.00
Federal Funds	17.38	18.50	10.63
Repurchase Agreements	16.25	17.63	9.50
U.S. Treasury Issues			
Bills			
3 months	15.50	15.97	8.88
6 months	16.13	16.38	9.17
1 year	16.00	16.04	9.28
Coupons			
2 years	15.75	15.61	9.61
4 years	15.38	15.12	9.90
7 years	14.88	14.64	10.00
10 years	14.63	14.40	10.65
Long Bond	13.88	13.65	10.62
Negotiable Certificates of Deposit-Secondary Market			
1 month	17.70	18.30	9.90
3 months	17.70	18.20	9.90
6 months	17.70	18.00	10.00
1 year	16.85	17.40	10.25
Banker's Acceptances			
1 month	17.60	18.60	9.55
3 months	17.75	18.40	9.55
6 months	17.90	18.30	9.55
Eurodollar Deposits			
1 month	18.50	18.88	10.38
2 months	18.63	18.75	10.44
3 months	18.63	18.88	10.50
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.25	18.25	9.00
1 month	17.38	17.50	8.75
3 months	16.50	16.75	8.75
Bank Holding Companies			
1 month	17.13	17.75	8.63
Dealer Placed:			
3 months	17.13	17.75	8.50
New AA Corporate Utility Bond	17.13	16.75	12.50
Tax Exempt			
6 month Project Notes	7.80	7.80	4.40
1 year AAA Bond	8.00	8.00	5.10
5 year AAA Bond	9.00	8.45	5.50
20 year AAA Bond	10.50	10.40	7.85

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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